FILED
NOV 23 1955
HAROLD B. WILLEY, Clerk

IN THE

Supreme Court of the United States

October Term, 1955.

No. 541

BROCKMAN BUILDING CORPORATION, INC., a corporation,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

A. CALDER MACKAY,
ADAM Y. BENNION,
STAFFORD R. GRADY,
523 W. Sixth St., Room 728,
Los Angeles 14, California,
Attorneys for Petitioner.

Parker & Son, Inc., Law Printers, Los Angeles. Phone MA. 6-9171.

SUBJECT INDEX

	PAGE
Jurisdictional statement	2
Question presented	3
Applicable provisions of the statutes and regulations	3
Statement of facts	5
Reasons relied on for allowance of writ	11
Appendix. Upon petition to review a decision of the Tax Court of the United States	App. p. 1

TABLE OF AUTHORITIES CITED

CASES — PAGE

Blair v. Commissioner, 300 U. S. 5, 81 L. Ed. 465 ..... 10, 11

Brockman Building Corporation, Inc. v. Commissioner, 21 T. C. 175 1

Denholm & McKay Realty Co. v. Commissioner, 139 F. 2d 545 ..... 2, 11, 15

Harrison v. Schaffner, 312 U. S. 579, 85 L. Ed. 1055 ..... 10, 11, 12

United States v. Joliet & Chicago R. Co., 315 U. S. 44, 86 L. Ed. 658 ..... 11, 14

STATUTES

Internal Revenue Code of 1939, Sec. 22 3

Internal Revenue Code of 1939, Sec. 272 10

Internal Revenue Code of 1954, Sec. 7482(a) 2

United States Code, Title 28, Sec. 1254 2

United States Code Annotated, Title 26, Sec. 22 3

United States Code Annotated, Title 26, Sec. 7482 2

TEXTBOOK

Internal Revenue Bulletin 1955-4, Revenue Ruling 55-38 ..... 4, 12

TREASURY REGULATIONS

Treasury Regulations 111, Sec. 29.22(a)-19 ..... 3, 14

Treasury Regulations 111, Sec. 29.22(a)-21 14

IN THE

Supreme Court of the United States

October Term, 1955.

No. .....

BROCKMAN BUILDING CORPORATION, INC., a corporation,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Petitioner, Brockman Building Corporation, Inc., respectfully shows to this Honorable Court that this is a petition for a writ of certiorari to the United States Court of Appeals for the Ninth Circuit to review a decision of that Court, copy of which is appended; the Circuit Court affirmed the decision of the Tax Court of the United States (*Brockman Building Corporation, Inc., v. Commissioner,* 21 T. C. 175).

Jurisdictional Statement.

The judgment of the Circuit Court was made and entered on September 27, 1955.

The order denying a petition for rehearing was made and entered on October 25, 1955.

The Supreme Court has jurisdiction to review the judgment here in question on the following grounds:

The original proceeding was brought in the Tax Court of the United States and a decision was rendered by such Court. Petitioner in due time filed a petition for review of said decision with the United States Court of Appeals for the Ninth Circuit, which in turn rendered its decision. The statutory authority conferring jurisdiction is Section 7482(a) of the Internal Revenue Code of 1954 (Title 26, U. S. C. A., Sec. 7482). This section provides that the Courts of Appeal shall have exclusive jurisdiction to review the decisions of the Tax Court of the United States; and the judgment of such Courts of Appeal shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in Section 1254 of Title 28 of the United States Code. The issues presented in this appeal are (1) whether the decision of the United States Court of Appeals for the Ninth Circuit is in conflict with the applicable decisions of this Honorable Court and (2) whether the decision is in conflict with the decision of the United States Court of Appeals for the First Circuit in the case of *Denholm & McKay Realty Co. v. Commissioner,* 139 F. 2d 545.

Question Presented.

WHETHER A CORPORATE LESSEE WHICH WAS NEVER A PARTY TO NOR HAD ANY INTEREST IN OR CONTROL OVER A CONTRACT PROVIDING FOR THE PAYMENT OF ADDITIONAL CONTINGENT RENTALS BY A SUBLESSEE TO THIRD PARTIES IS TAXABLE ON SUCH ADDITIONAL RENTALS.

Applicable Provisions of the Statutes and Regulations.

Internal Revenue Code of 1939:

> "§22. GROSS INCOME.
>
> (a) *General definition.* 'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *" (26 U. S. C. A., Sec. 22.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

> "Sec. 29.22(a)-19. *Income to lessor corporation from leased property.*—If a corporation has leased its property in consideration that the lessee shall pay in lieu of other rental an amount equivalent to a certain rate of dividend on the lessor's capital stock or the interest on the lessor's outstanding indebtedness,

together with taxes, insurance, or other fixed charges, such payments shall be considered rental payments and shall be returned by the lessor corporation as income, notwithstanding the fact that the dividends and interest are paid by the lessee directly to the shareholders and bondholders of the lessor. The fact that a corporation has conveyed or let its property and has parted with its management and control, or has ceased to engage in the business for which it was originally organized, will not relieve it from liability to the tax. While the payments made by the lessee directly to the bondholders or shareholders of the lessor are rentals as to both the lessee and lessor (rentals paid in one case and rentals received in the other), to the bondholders and the shareholders such amounts are interest and dividend payments received as from the lessor and as such shall be accounted for in their returns."

Revenue Ruling 55-38, Internal Revenue Bulletin 1955-4:

"Where the lifetime income beneficiary of a testamentary trust from time to time gives his written consent, pursuant to the terms of the will, to pay a certain portion of the trust income to another individual, the amounts so paid will be taxable as income to the beneficiary inasmuch as he, in point of substance, has parted with no substantial interest in property other than the specified payments of income. See Harrison v. Sarah H. Schaffner, 312 U. S. 579, Ct. D. 1503, C. B. 1941-1, 321. However, in the case of an irrevocable assignment, valid under local law, of trust income for a period of not less than 10 years, such income will be taxable to the assignee, provided the facts are not such as would subject the lifetime income beneficiary (the assignor)

to the tax on the income under the principles of section 39.22(a)-21 of Regulations 118, section 167 of the Internal Revenue Code of 1939, Edward B. Douglas v. Willcuts, 296 U. S. 1, Ct. D. 1041, C. B. XIV-2, 250 (1936), or I. T. 4007, C. B. 1950-1, 11. In such a case the position of the assignor is analogous to that of the grantor of a trust. Under such circumstances, because of the period and character of the assignment, the lieftime income beneficiary will be considered to have made a disposition of a substantial interest in the trust property. See Edward T. Blair v. Commissioner, 300 U. S. 5, Ct. D. 1205, C. B. 1937-1, 175."

Statement of Facts.

Petitioner is a corporation organized under the laws of the State of California. In 1933 petitioner leased the Brockman Building, in Los Angeles, from its owner, the Security-First National Bank of Los Angeles, as Trustee for the Brockman heirs.* The lease required petitioner to pay to the bank, as rent, all of its gross receipts, less certain specified operating expenses. The lease was to run until July 31, 1942, and if by that time the gross rentals received by the lessor-bank did not average a minimum of $3,500.00 per month from 1933 to July 31, 1942, the lease, at the option of the lessor, could be cancelled. By December 31, 1941, petitioner was delinquent in its minimum rentals by the sum of approximately $100,000.00 and cancellation of its lease by July 1, 1942, was practically a certainty. Petitioner's sublease with its principal tenant, J. J. Haggarty Stores, Inc., a large re-

*Not related to shareholders of Brockman Building Corporation, Inc.

tail women's clothing store in Los Angeles, was due to expire on March 14, 1942, and because of the imminent cancellation by the bank of petitioner's basic lease Haggarty would not negotiate for an extension of its own sublease without the bank's consenting to become its lessor in the event of the termination of petitioner's basic lease, whereupon, at the insistence and with the approval of petitioner's lessor, of its only creditors and of its stockholders, the following arrangements were made at arm's length, not dictated by tax considerations:

(1) Haggarty on March 3, 1942, entered into a new sublease with petitioner for a term expiring September 30, 1961, which required Haggarty to pay a fixed rental of $5,500.00 per month. This fixed rental was a substantial increase over the previous rental paid by Haggarty and was probably a better rental than could be obtained from any other prospective tenant.

(2) Petitioner on March 3, 1942, entered into an amendment of its basic lease from the bank, which extended until 1956 the time for determining whether petitioner was in default in payment of its $3,500.00 per month minimum rental to the bank. This amendment also provided for payment as rental to the bank of all of petitioner's receipts (except for operating expenses and small management fees) from the Brockman Building for as long as Haggarty was not in default in its new sublease.

(3) Haggarty also, on March 3, 1942, entered into a separate agreement solely with Title Insurance and

Trust Company (a corporation entirely independent of the bank, petitioner or Haggarty) wherein Haggarty agreed to pay to the Title Company for the period from March 3, 1942, to September 30, 1961, 4½% of its gross sales between $1,400,000.00 and $1,800,000.00, and 4% of its gross sales over $1,800,000.00. Payment of any of the contingent amounts was a possibility only, as Haggarty sales had never reached the amounts stated. The bank, as owner of the building and as petitioner's lessor, relinquished any possible future claims to this percentage rental. Petitioner was not a party to or recipient or beneficiary of the percentage of sales agreement, since the bank, as owner of the building, felt that the inclusion in the sublease between petitioner and Haggarty of the provision requiring contingent percentage rentals, which petitioner's contingent bondholders and stockholders insisted be assigned out by petitioner for their benefit, might result in an undesirable future conflict of interest with the bank's right to receive the Haggarty fixed rental.

(4) Pursuant to the foregoing arrangement Title Insurance and Trust Company executed a declaration of trust which provided that the percentage payments received by it from Haggarty, after payment of trustee's fees, were to be held in trust for named beneficiaries. The net payments available for distribution were to be divided into two portions of 55% and 45% to be paid over to the contingent bondholders and to the named then

stockholders of petitioner, respectively. Such portions were to be distributed as follows:

Beneficiary	Proportion
55% of Net Payments	
Pioneer Securities Corporation	17/92
Pacific Indemnity Company	75/92
45% of Net Payments	
John Shirley Ward	85/1000
Chandler P. Ward	85/1000
Shirley C. Ward, Jr.	85/1000
Robertson Ward	85/1000
Katherine Ward Carr	85/1000
Beatrice Ward Challiss	85/1000
Emma B. C. Wells	245/1000
Harold S. Chase	245/1000

At the time of the execution of the declaration of trust the individuals named above were the stockholders of petitioner. Pioneer Securities Corporation and Pacific Indemnity Company were bondholders of petitioner's predecessor. Petitioner in obtaining its original lease of 1933 from the bank agreed to pay these bondholders the sum of $92,000.00, only out of any earnings of petitioner from the Brockman Building in excess of the minimum rentals due the bank, *i.e.*, only after the bank had received an average of $3,500.00 per month from 1933 to July 31, 1942.

(5) The beneficial interests under the Title Company trust, by the specific terms thereof, were transferable. These beneficial interests are a species of property under California law. Moreover, the right to receive any beneficiary's portion of the percentage payments is not de-

pendent upon the continued ownership of any stock of petitioner. Not only are the beneficial interests independent of continued ownership of any stock in the petitioner, but also they are completely unrelated to stock ownership. Such percentage payments will continue to the Title Company and to the trust beneficiaries notwithstanding petitioner's default in, cancellation or assignment of its basic lease of the Brockman building and notwithstanding whether petitioner ceases to exist.

By June 1, 1945, the contingent bondholders had received full payment for the bonds in distributions from the Haggarty trust, and thereafter the individually named beneficiaries and the assignees of one of them received the entire proceeds from Title Insurance and Trust Company.

In November, 1946, the Haggarty trust was amended with the consent of the Title Company and of all the then trust beneficiaries, including Morton, who as hereinafter stated purchased a beneficial interest but did not become a stockholder. Neither Haggarty, the bank nor petitioner was a party to this trust amendment. In June, 1947, the Brockman-Haggarty sublease was amended, in details not here relevant. Neither the Title Company nor any of the beneficiaries of the Haggarty trust was a party to such sublease amendment. On November 30, 1948, the percentage of sales agreement of March 3, 1942, between Haggarty and the Title Company was amended, reducing Haggarty's obligation thereunder with the consent of all of the then beneficiaries of the Haggarty trust. The petitioner and the bank were not parties, nor was their consent sought, to this amendment.

For all times pertinent to this proceeding, except as noted below, the trust beneficiaries as listed above were

all of the stockholders of petitioner and owned stock in the proportions as there set forth. Harold S. Chase owned 245 shares of petitioner's stock which he had acquired from David Blankenhorn on September 24, 1936. On August 24, 1945, Harold C. Morton acquired for value from Harold S. Chase a 122½/1000 beneficial interest in the Haggarty trust. On the same date David Blankenhorn also acquired for value from Harold S. Chase a 122½/1000 beneficial interest in the same trust. David Blankenhorn also on August 24, 1945, reacquired from Harold S. Chase 245 shares of the stock of petitioner. Harold C. Morton was never a stockholder of petitioner. Blankenhorn owned twice as much stock as beneficial interest in the trust.

Notwithstanding the fact that (1) petitioner was not a party to the percentage of sales contract between Haggarty and the Title Company* and (2) petitioner neither owned, controlled, received nor had a right to receive or control these percentage of sales payments, the Tax Court of the United States nevertheless held that petitioner was liable for income tax thereon. The United States Court of Appeals for the Ninth Circuit affirmed the decision of the Tax Court, which is in direct conflict with the rules of law established by this Honorable Court in the cases of *Harrison v. Schaffner*, 312 U. S. 579, 85 L. Ed. 1055, and *Blair v. Commissioner*, 300 U. S. 5, 81 L. Ed. 465.

The case originated with a petition filed with the Tax Court of the Uinted States under Section 272 of the Internal Revenue Code of 1939 to review the final decision of the Commissioner of Internal Revenue.

---

*Petitioner was excluded from this contract at the insistence of the bank as owner of the premises.

Reasons Relied on for Allowance of Writ.

(1) The decision of the Circuit Court is in conflict with the law established by this Honorable Court in the cases of *Blair v. Commissioner,* 300 U. S. 5, 81 L. Ed. 465, 57 S. Ct. 330, and *Harrison v. Schaffner,* 312 U. S. 579, 85 L. Ed. 1055.

(2) The decision of the Circuit Court is in conflict with the principle of law laid down by this Court in the case of *United States v. Joliet & Chicago R. Co.* (1942), 315 U. S. 44, 86 L. Ed. 658.

(3) The decision of the Circuit Court is in conflict with the decision of the United States Court of Appeals for the First Circuit in the case of *Denholm & McKay Realty Co. v. Commissioner,* 139 F. 2d 545.

The Circuit Court's opinion is based principally upon the ground that petitioner as sublessor of the property is taxable upon the rental produced by that property, notwithstanding that it has completely divested itself of all right, title and interest in said rentals, in effect making an absolute assignment to third persons. In so holding the Court relied upon the cases dealing with so-called anticipatory assignment of income, stating that if the sublessor could escape tax under such circumstances a new way to avoid income tax would be opened up.

Petitioner respectfully submits to the Court that in so holding the Circuit Court did not take into account the distinction, created and maintained by this Honorable Court, between anticipatory assignments of income on one hand, where the assignor admittedly remains liable for tax on the income directed to be paid to another, and, on the other hand, what amounts to an absolute assignment of the entire beneficial ownership of property

itself, which latter type of assignment is effective to transfer the burden of the income tax to the assignee-owner.

This clear-cut distinction has been recognized time and again by the Supreme Court and by other Courts, but it has never been more clearly stated than by this Honorable Court in the leading case of *Harrison v. Schaffner* (1941), 312 U. S. 579, 85 L. Ed. 1055, in which the life beneficiary of a trust had assigned simply her right to income for the year following the assignment and the Court drew the distinction between that type of an anticipatory assignment of income and an assignment by a life beneficiary of a portion of her right to income for the *entire life* of the trust. The Court said:

> "* * * It is true, as respondent argues, that where the beneficiary of a trust had assigned a share of the income to another *for life without retaining any form of control* over the interest assigned, this Court construed the assignment as a transfer *in praesenti* to the donee, of a life interest in the corpus of the trust property and held in consequence that the income thereafter paid to the donee was taxable to him and not the donor. Blair v. Commissioner of Internal Revenue, 300 U S 5, 81 L ed 465, 57 S Ct 330 * * *"

Following the principle of law thus established by this Court the Internal Revenue Service issued the following ruling (Rev. Rul. 55-38; I. R. B. 1955-4):

> "Where the lifetime income beneficiary of a testamentary trust from time to time gives his written consent, pursuant to the terms of the will, to pay a certain portion of the trust income to another individual, the amounts so paid will be taxable as income to the beneficiary inasmuch as he, in point of substance, has parted with no substantial interest in

property other than the specified payments of income. See Harrison v. Sarah H. Schaffner, 312 U. S. 579, Ct. D. 1503, C. B. 1941-1, 321. However, in the case of an irrevocable assignment, valid under local law, of trust income for a period of not less than 10 years, such income will be taxable to the assignee, provided the facts are not such as would subject the lifetime income beneficiary (the assignor) to the tax on the income under the principles of section 39.22 (a)-21 of Regulations 118, section 167 of the Internal Revenue Code of 1939, Edward B. Douglas v. Willcuts, 296 U. S. 1, Ct. D. 1041, C. B. XIV-2, 250 (1936), or I. T. 4007, C. B. 1950-1, 11. In such a case the position of the assignor is analogous to that of the grantor of a trust. Under such circumstances, because of the period and character of the assignment, the lifetime income beneficiary will be considered to have made a disposition of a substantial interest in the trust property. See Edward T. Blair v. Commissioner, 300 U. S. 5, Ct. D. 1205, C. B. 1937-1, 175."

In the present case, as the Circuit Court stated, the source of the income ("the income producing res" (Op. p. 7)) was petitioner's basic lease, *i.e.*, the lease from the bank as owner of the real property to the petitioner corporation. We cannot overemphasize the fact that petitioner was not the owner of the land. It was a lessee of the land and, as the Circuit Court stated in its opinion, its lease was and is for a term ending September 30, 1961. Upon that date petitioner corporation will cease to have any property whatsoever insofar as this lease or the Brockman Building is concerned. From and after March 3, 1942, petitioner had absolutely no interest in that portion of the income produced by said res since it,

at the insistence of the owner, had completely divested itself thereof in favor of others. In short, the divestment or assignment by petitioner was as effective and as all-inclusive as the assignment in the *Blair* case.

The significance of the present situation is that the taxpayer has assigned to others the entire complete beneficial interest in the percentage of sales rental income from that property until September 30, 1961. The situation seems to petitioner so much stronger than was the situation in the *Blair* case or in the 1955 Revenue Ruling cited above, where the owner of the property had assigned merely an undivided interest in the income for the duration of the trust. In our case the taxpayer has assigned 100% of its entire beneficial interest in the income-producing property, so far as concerns the percentage of sales rentals, for the entire duration of that property.

The failure to apply the principles of law hereinabove referred to results in an extreme injustice since the income creating petitioner's tax liability has not been and never will be available to petitioner for the discharge of that liability. The beneficiaries of the trust have reported the income from the trust and have paid income taxes thereon.

This Court in the case of *United States v. Joliet & Chicago R. Co.* (1942), 315 U. S. 44, 86 L. Ed. 658, sustained Treasury Regulations 111, Section 29.22(a)-19 and 21 (see appendix), in holding that payment by the lessee of dividends "in lieu of other rentals" directly to the lessor's stockholders did not relieve the lessor from the tax thereon since the rentals (dividends) were required to be paid by the lessee to those who should be the stockholders of the lessor at the time the payments were made. No such requirement was made in the instant case.

The United States Court of Appeals for the First Circuit in the case of *Denholm & McKay Realty Co. v. Commissioner,* 139 F. 2d 545, held that a lessor was not taxable on rental dividends paid by the lessee directly to the lessor's stockholders since the lessee's obligation to pay the preferred dividend to the lessor's stockholders was not contained in the lease which called for adequate rentals but was independently created through a series of guaranties endorsed by the lessee on the lessor's preferred stock certificates.

In view of the foregoing it is respectfully urged that this petition be granted in order that this Honorable Court may pass upon these important questions and reverse the decision of the United States Court of Appeals for the Ninth Circuit relieving petitioner of the grievous injustice that has thereby been done it.

Respectfully submitted,

A. CALDER MACKAY,

ADAM Y. BENNION,

STAFFORD R. GRADY,

Attorneys for Petitioner.

APPENDIX.

United States Court of Appeals for the Ninth Circuit.

Brockman Building Corporation, Inc., a corporation, Petitioner, vs. Commissioner of Internal Revenue, Respondent. No. 14,363.

Sep. 27, 1955.

Upon Petition to Review a Decision of The Tax Court of the United States.

Before: Pope, Fee and Chambers, Circuit Judges.

James Alger Fee, Circuit Judge:

The petition for review of the determination of the Tax Court involves deficiencies in income, declared value excess profits tax and excess profits tax for the taxable years 1942 to 1949, inclusive.

The question presented is whether the Tax Court correctly held that payments made by the sublessee of the taxpayer, through the medium of a trust, directly to the stockholders and bondholder-creditors of Brockman Building Corporation, petitioner here, constituted part of the rental owing by the sublessee under a percentage of sales agreement and were income to the taxpayer.

In 1933, the Security-First National Bank of Los Angeles, owner, as trustee under a trust established in 1922, leased the Brockman Building to petitioner for twenty-eight years. The lessee did not occupy the premises, but subleased them. In the lease, it was provided petitioner would pay to the Bank all gross receipts, less certain listed operating expenses. The lease was subject to cancellation if net rentals from March 1, 1933, to July 31, 1942, did not average $3,500.00 per month, but, if that average had been attained, the net rental after July 31, 1942, would

be fixed at $3,500.00 per month and petitioner was to retain any excess rental it was able to secure. Petitioner, however, not only failed to realize the average of $3,500.00 per month, but was by January 1, 1941, quite delinquent under the lease. This delinquency in payment of minimum rentals exceeded $100,000.00 on March 31, 1942. It was obvious the Bank must cancel the lease for security of the interests of the trust by July 31, 1942. However, despite the default, petitioner had reasonable prospects of avoiding cancellation if increased income could be obtained. It had managed the building efficiently and turned over all the funds which it had been able to obtain from rentals to the lessor, the trustee Bank.

The situation was further complicated by other facts in the background. Before 1933, the Bank had leased the same building to another corporation, Brockman Building Company, which had issued bonds to Pacific Indemnity Company and Pioneer Securities Corporation. In the financial rearrangement of 1933, whereby the original lease to petitioner was executed, it was required to agree to purchase these bonds of face value of about $92,000.00. This was done by written agreement between petitioner and the companies owning the securities. Payment was to be made from its earnings in excess of $3,500.00 per month from its basic lease. But, as has been seen, there was no excess, but a heavy deficit. In order to secure payment for these bonds, Pacific Indemnity and Pioneer Securities were assigned the interest of the lessee, Brockman Building Corporation, in the lease between the Bank and petitioner. The stockholders of petitioner were likewise compelled to assign their respective stock to the selling companies. During the time the assignment was in effect, the consents of the selling companies were re-

quired to any amendment of this lease. But, upon payment therefor, these were to reassign the lease.

The principal subtenant of petitioner under its basic lease was J. J. Haggarty Stores, Inc. This sublease, as well as a lease on an adjoining building which Haggarty used in connection, was about to expire, March 14, 1942. This circumstance was apparently very lucky for petitioner because negotiations carried on principally by John Shirley Ward, Chandler P. Ward and David Blankenhorn, who were officers of petitioner and all but the last were stockholders, which had been proceeding for some two years, culminated near the first of 1942, when circumstances might indicate large profits could be anticipated by the sublessee.

About this time a proposed sublease for Haggarty was submitted to the Bank. This instrument provided for an increased fixed rental, and contingent rentals equal to a percentage of Haggarty's gross sales over a certain amount were to be paid to petitioner by Haggarty. The fixed amount was to be paid over to the Bank by petitioner. The contingent rentals were to be retained by petitioner, who was to assign them to John Shirley Ward or to his nominees, who were to be shareholders and bondholder-creditors of petitioner. The Bank refused to consent to this sublease.

Thereupon, a method of accomplishing the same result satisfactorily to the Bank was evolved. On March 3, 1942, a sublease was entered between petitioner and Haggarty, which provided for the payment of fixed rental only. The Bank and the bondholders executed consents to the sublease. The Bank relinquished any possible future claims to percentage rentals. On the same date, Haggarty entered into a separate agreement with Title

and Trust Company, wherein it agreed to pay to that company the stipulated percentages of gross sales. As trustee, the Title Company obligated itself to pay these percentages, less its compensation and expenses of the trust to named stockholders of petitioner in proportion to their stock holdings and to the bondholder-creditors.

The forecast as to expected profits was eminently accurate. The payments of percentage rentals by Haggarty were so lush that the bondholders were paid in full by June 1, 1945. (The bonds were cancelled and turned over to petitioner!) From 1942 to 1949, inclusive, the stockholders received $590,000.00 from this source.

The persons who received these percentage payments were two creditors of petitioner and stockholders of petitioner. It was expressly understood and agreed that Pioneer Securities and Pacific Indemnity, when the balance of the principal of bonds held by them respectively was paid, the interest of each of these companies in the "trust and in the lease should terminate" and, significantly, also "any excess [would] then pass to the stockholders in accordance with their stock interests."

The Tax Court held that these amounts were income to petitioner and that tax was due upon them. The Tax Court found facts which made this conclusion inescapable. These findings were well founded in the evidence and were not clearly erroneous. There was no question of law involved.

Petitioner was the owner of a leasehold estate in the Brockman Building. The Bank might have cancelled the lease and ended the term, but it chose not to do so. Anything Haggarty paid for the occupancy was paid to or on account of petitioner. If A, the lessor, says to B,

the lessee, "You do not need to pay rent to me directly, if you pay C, to whom I owe money," the money so paid is income to A.[1] The lease which the Bank turned down shows the true situation. If any debtor can have his creditor paid by such indirect methods, a new way has been discovered to evade income tax.[2]

There are two arguments with which we should deal. It is contended first that the Bank created a *profit a prendre* in the creditors and stockholders, and second that the payments were not made to creditors and stockholders as such.

As to this first point, the authorities cited from the state courts of California do not intimate even remotely that the interest of the stockholders and debtors in these payments was such common law estate.[3] It would seem a perversion of concepts to attempt to distort such a category in order to include the right to these payments. But one objection to this construction is transcendent. The Bank did not purport to grant such a right and it had no power to make such a grant. The lease between the Bank and petitioner was not cancelled, abrogated or

---

[1]Income "is not any the less taxable income of the taxpayer because * * * it is paid directly to another in performance of the taxpayer's obligation to that other." Raybestos-Manhattan Co. vs. United States, 296 U. S. 60, 64.

[2]The courts have used the doctrine of anticipatory assignment to foil "arrangements and contracts however skilfully devised to prevent the salary when paid from vesting even for a second in the man who earned it." Lucas vs. Earl, 281 U. S. 111, 115. The Tax Court relied strongly on United States vs. Joliet & Chicago Railroad Co., 315 U. S. 44, a persuasive but not altogether conclusive decision.

[3]Civil Code of California (Deering, 1949 Ed.) 802(4); Callahan vs. Martin, 3 California 2d 110; Dabney-Johnson Oil Corporation vs. Walden, 4 California 2d 637; Tanner vs. Title Insurance and Trust Co., 20 California 2d 814.

surrendered. That lease was dated July 29, 1933, and the term expired September 30, 1961. This term was not changed by the amendment thereof dated March 3, 1942, and petitioner still owned a leasehold expiring September 30, 1961. There is nothing in the particulars in which the lease was amended which indicates a purpose to convey a vested interest in the lease or the rentals to the stockholders and creditors of petitioner. Instead, the Bank and petitioner "reconfirm and ratify" the original lease for the term ending September 30, 1961, to petitioner, saving "only in the particulars" where express changes were made.

The Bank had consistently refused to have a partner in the lease. By this refusal, culminating in the amendment which, as noted, reiterated the terms of the original master-lease agreement without material change, it simply washed its hands of the creditors and stockholders of petitioner, as it had said from the beginning of the negotiations for the new Haggarty sublease arrangement. There was never power in the Bank to enforce its own lease for the benefit of the stockholders and creditors of petitioner or to convey to these persons any segment of the property interest which it theretofore had entirely conveyed to the Brockman company. Also, the Bank did not approve the original sublease with Haggarty, which gave such parties the right to claim sublease proceeds against the Brockman company by virtue of the contemplated assignment.

Never from the time the Bank leased to Brockman did it have the right or power to create any interest in the nature of *profit a prendre* in the estate thereby vested in petitioner. Therefore, to enforce provisions for their benefit in the sublease to Haggarty, the creditors and

stockholders were compelled to have the interest of Haggarty transferred in trust to assure themselves that they would receive the payments contemplated thereby. This was accomplished by striking these provisions for payment from the text of the new Brockman Building Corporation-Haggarty sublease, and in lieu thereof Haggarty agreed to transfer these payments of percentages of the profits in trust for their benefit.

Whichever way this transaction had been handled, the fact remains that the income producing res was the leasehold interest vested entirely in Brockman and all the rentals arising therefrom were income to Brockman. It is immaterial that the arrangements for the payment of this income took another form because of the objections of the Bank. The Tax Court was correct in its conclusion that the plan "whereby the contingent rentals were to be paid into the trust for the benefit of petitioner's stockholders and creditors, was merely a change in form from the plan which was rejected by the Bank."

The stockholders of petitioner received these payments in compensation for the sublease of property of petitioner. The creditors of petitioner received such installments as its creditors and in payment of their debts. Thus the payments were the proceeds of property of the petitioner and under the statute were income to it.

There was no business purpose to be subserved for the benefit of petitioner by the execution of the documents which siphoned off its income for the benefit of its creditors and stockholders. If any stockholder had been left out of the distribution or had not consented thereto, the petitioner could have been required to bring action to set this conveyance aside. Failing that, the stockholder excluded could have attacked the conveyance upon his own

account. The document purports to state that the consideration therefor was the effort of certain stockholders in obtaining the consents necessary to have the Haggarty lease put in force. So far as petitioner was concerned this consideration was illegal, since all of these stockholders, agents and officers were bound as fiduciaries to protect its interest and not convert its property for their own benefit. It is significant that although only three of the stockholders were active in these negotiations they did not presume to take all the proceeds but included all the stockholders. Of course, from the discussion above, it will be seen that this was an obvious precaution. The stockholders, therefore, were intended to receive these payments as dividends. The fact that the payments were assigned by a stockholder to another who was not a stockholder and that the conveyance has been upheld does not militate against this conclusion. A stockholder can assign his right to dividends. There was evidence that the parties intended that the payments should "pass to the stockholders in accordance with their stock interests," at least after the payment of the two creditors.

It is of great importance that in the first instance the Haggarty lease was drafted to include payment of these percentages as part of the rent to petitioner. The Bank, however, refused to accede to the assignment of a portion of the rentals to the assignee of petitioner and refused to accept an assignment of petitioner's rights in the sublease to Haggarty, which assignment contained a clause to the effect the petitioner "having heretofore assigned unto ..... all of its right, title and interest as such Lessor in and to the percentage rentals payable and to be paid by the Lessee under said sublease, together with a sufficient interest in said sublease to en-

force the same and together with its entire right as Lessor therein to collect and enforce collection of said percentage rentals, does * * * assign" to the Bank "all of its unassigned right, title and interest in and to said sublease, excepting and reserving, however, the percentage rentals payable and to be paid thereunder and excepting and reserving its right to assign unto said ..... to collect and enforce the collection of the same."

It is ironical enough that if the Bank had accepted and consented to this situation some faint color might have been infused into the contentions of petitioner. But the Bank refused. The Bank declined "to have in the lease a partner, whose percentage interest might affect [its] fixed interest." The stockholders and attorneys of petitioner therefore found "it would be necessary to segregate from the lease those provisions relating to percentage rentals." The Bank was well advised.

This genesis of the subsequent transactions and the specific characterization of the proposed payments to the unnamed assignee as *percentage rentals* removes any doubt that they were income to petitioner.

The Bank had a right to refuse Haggarty as a subtenant, but it could not provide that what was paid as rental should pass directly to creditors and stockholders of petitioner without becoming income to the latter.

Affirmed.

(Endorsed:) Opinion. Filed Sep. 27, 1955. Paul P. O'Brien, Clerk.